2013

The Financial Crisis and Temporary Liquidity Guarantee Program: Their Impact on Fixed-Income Markets

Brett W. Ambrose

Yiying Cheng

Tao-Hsien Dolly King

Journal of Fixed Income

Fall 2013, 23 (2) 5-26

The Financial Crisis and Temporary Liquidity Guarantee Program: Their Impact on Fixed-Income Markets

Brent W. Ambrose,

Yiying Cheng

Tao-Hsien Dolly King

Abstract

The authors examine the Federal Deposit Insurance Corporation's (FDIC's) Temporary Liquidity Guarantee Program to determine the effectiveness of this government-sponsored solution for the recent banking crisis. They explore the impact of the program on the liquidity and credit crisis in the debt markets and the market value of the FDIC guarantee. They find a negative and significant two-day abnormal stock return of –1.53% around FDIC-backed debt issue dates, suggesting stockholders held pessimistic views on the future prospects of the banks. Bondholders reacted positively to the issuances, with a two-day excess return of 0.32%, confirming the positive liquidity and credit effects in the debt market.

The authors also find a significant drop in yield spreads of AAA debt issues around the announcements of FDIC-guaranteed debt issues. Using multiple regressions, they confirm the drop in yield spreads of AAA financial bonds after the program started. Both findings suggest that the program effectively encouraged liquidity and confidence. Finally, FDIC-backed debt trades at a discount of 132 bps to nonguaranteed debt, implying that the guarantee is valuable.

Recommended Citation: Ambrose, Brent W, Yiying Cheng, and Tao-Hsien Dolly King. The Financial Crisis and Temporary Liquidity Guarantee Program: Their Impact on Fixed Income Markets. The Journal of Fixed Income, 23(2): 5-26, 2013.